97-84154-25

U.S. Office of Price Administration

The essential role of subsidies in the...

[Washington]

[1944]

97-84154-25
MASTER NEGATIVE #

COLUMBIA UNIVERSITY LIBRARIES
PRESERVATION DIVISION

BIBLIOGRAPHIC MICROFORM TARGET

ORIGINAL MATERIAL AS FILMED - EXISTING BIBLIOGRAPHIC RECORD

308
Z
Box 663

U. S. *Office of price administration.*
The essential role of subsidies in the stabilization program. United States of America, Office of price administration. Washington, U. S. Govt. print. off., 1944.
cover-title, iv, 23 p. 23½ cm.

1. Price regulation—U. S. 2. Bounties.

44-41015
Library of Congress HB236.U5A53 1944 e
[3] ONLY ED. 338.526

RESTRICTIONS ON USE: *Reproductions may not be made without permission from Columbia University Libraries.*

TECHNICAL MICROFORM DATA

FILM SIZE: 35mm REDUCTION RATIO: 11:1 IMAGE PLACEMENT: IA (IIA) IB IIB

DATE FILMED: 8/6/97 INITIALS: TC M

TRACKING # : 26474

FILMED BY PRESERVATION RESOURCES, BETHLEHEM, PA.

D/J OPA

THE ESSENTIAL ROLE OF SUBSIDIES IN THE STABILIZATION PROGRAM

COLUMBIA UNIVERSITY LIBRARIES
JUN 5 1944
RECEIVED

308
Z
Bo4663

UNITED STATES OF AMERICA
OFFICE OF PRICE ADMINISTRATION

UNITED STATES GOVERNMENT PRINTING OFFICE • WASHINGTON : 1944

For sale by the Superintendent of Documents, U. S. Government Printing Office
Washington 25, D. C. - Price 10 cents

S/23/44 v.d.
SEP 8 1944 PCR

FOREWORD

The President's program to "hold the line" under the provisions of the Stabilization Act of October 2, 1942, is one year old this month. The effectiveness of that program in stabilizing the cost of living is demonstrated by the fact that since April 1943 the cost of living index of the Bureau of Labor Statistics has shown no significant change. Against this record of performance, much of the early criticism of the program has subsided and a cooler analysis of its several aspects has become possible.

No part of the program has aroused sharper controversy than the use of subsidies and on no part, in my judgment, can a careful presentation of the underlying issues and problems be more helpful. This pamphlet on subsidies in the stabilization program has been prepared for the staff of the Office of Price Administration and for the field staff in particular. The National Office, the Field Offices, and the local War Price and Rationing Boards have been flooded with questions about subsidies and the reasons for their use in the "hold the line" program. I believe this pamphlet will put before members of the staff an explanation of the policy and the important facts about subsidies.

Just because the issue is so controversial, with men of good will and judgment found on each side, I have been anxious that the presentation of the policy be as fair and objective as possible. I think that test has been met in the following pages, and that this pamphlet sets forth the considerations which led us to the conclusion that subsidies . . . used carefully and in limited amounts . . . are essential to full success in stabilizing the war economy.

CHESTER BOWLES,
Administrator.

April 1944.

548954°—44——1

CONTENTS

Page

1. Subsidies in the Development of the Stabilization Program . . . 1
   - Rising Living Costs Prior to April 1943.
   - The Program to Halt the Rise.

2. Why Subsidies Must be Used 3
   - Two Objectives: Production and Stability.
   - Price Need Not Be the Sole Source of Return.
   - War Strains Force Costs Up.
   - Price Increases Must Be Used Sparingly.

3. Savings Made Possible by the Use of Subsidies 5
   - Direct Savings.
   - Indirect Savings.
   - Differential Subsidies.

4. Methods of Granting Subsidies 12
   - Direct Payment.
   - Purchase and Sale.
   - Operation at a Loss.

5. Analysis of Objections to Subsidies 13
   - Objection 1: "Subsidies Lower Prices, are Therefore Inflationary!"
   - Objection 2: "Subsidies Increase War Expenditures, thus Feed Inflation."
   - Objection 3: "Subsidies Shift Our Grocery Bill Onto the Future."
   - Objection 4: "Subsidies Only Conceal Price Rises."
   - Objection 5: "Consumers Can Afford Higher Prices."
   - Objection 6: "Costly Subsidies—Tiny Savings."
   - Objection 7: "If Subsidies Are Used Now, Won't Prices Fall When They Are Withdrawn After the War?"
   - Objection 8: "Subsidies Are No Substitute for Enforcement."
   - Objection 9: "Subsidies Are Subject to Abuse."
   - Objection 10: "Subsidies Are Valueless Unless Wages Are Completely Frozen."

QUALIFIED OBJECTIONS Page

Objection 11: "Producer Subsidies Are Good—Consumer Subsidies Are Bad."
Objection 12: The Alternative of a "Food Stamp Plan."
Objection 13: "Subsidies on Marginal Production Are Good —Subsidies 'Across the Board' Are Bad."
Objection 14: "Holdback" Subsidies Approved—"Rollback" Subsidies Disapproved.

6. The Test of Performance 22

THE ESSENTIAL ROLE OF SUBSIDIES IN THE STABILIZATION PROGRAM

Subsidies were first used in stabilizing the cost of living in June 1943. The relative lateness of their initial use for this purpose has tended to obscure the fact that since the beginning of price stabilization subsidies have been recognized as providing an anti-inflationary technique.

In the Emergency Price Control Act of 1942, the Congress recognized that under the policy of stabilizing prices adopted in that legislation, occasions would arise in which the return to producers would be too low to secure maximum necessary production. The usual method of securing such production is, of course, to pay a price high enough to cover all the costs entailed. Once the primary decision has been made that price rises are to be prevented, however, this method must be used with restraint and in some circumstances must be wholly avoided. Accordingly, in Section 2 (e) of the price control statute the Congress specifically authorized the Price Administrator, whenever he "determines that the maximum necessary production of any commodity is not being obtained . . . [to] make subsidy payments to domestic producers of such commodity in such amounts and in such manner and upon such terms and conditions as he determines to be necessary to obtain the maximum necessary production thereof."

The fundamental purpose of subsidies in relation to price control was thus recognized at the outset. The actual use of subsidies developed only as the circumstances of the stabilization program required. In this connection, it should be borne in mind that the stabilization program did not come into being full-blown and complete in every detail. The general requirements of a policy of economic stabilization were, to be sure, known at an early date. The pattern of controls imposed in making that policy effective has developed as a matter of practical experience in dealing with the growing and spreading pressures of the wartime economy.

1. Subsidies in the Development of the Stabilization Program

Beginning in June 1940 with what was virtually a "price watching" program, stabilization measures have expanded as inflationary pressures have grown. Price watching became price control. Price control, originally selective in nature, was made general in the spring of 1942. Later, farm prices were made more fully subject to control. The fiscal program, embracing taxes, savings, and credit control, was progressively harnessed to the requirements of economic

stability. Rationing of consumer goods was introduced to insure equitable distribution and was extended as new shortages of essential goods appeared. Control of wage rates was imposed by the Stabilization Act, both to relieve the pressure of labor costs upon prices and to slow down the growth of purchasing power.

Thus from a small beginning in 1940, appropriate to the minor dimensions of the problem that then existed, national policy has developed a broad, many-sided program of economic stabilization, geared to the tremendous strains of an all-out war economy. This gearing would be fatally incomplete, however, without the use of the subsidy technique. That fact is demonstrated by the experience of the year following April 1943.

Rising Living Costs Prior to April 1943

Between September 1942, the month set by the Congress in the Stabilization Act as the base for wage and cost-of-living stabilization, and April 1943, the cost of living rose 5.3 percent, the cost of foods 11 percent. A continuation of this same rate of increase would by April 1944 have brought the cost of living 15 percent above the level named in the statute. Actually, under the program that was developed to implement the President's hold-the-line order, the cost of living, which rose again in May, was reduced for 3 successive months and then was stabilized within a very narrow range of fluctuation. In April 1944, 1 year after the issuance of the hold-the-line order, the cost of living still shows no significant net change. This means that after 2½ years of steady increase in the cost of living the line has been held for a solid year.

During this period the inflationary pressures did not lessen, but on the contrary increased. On the demand side, total income, even after new taxes, kept rising as longer hours were worked and the net shift of workers to better-paying jobs continued. Meanwhile, production for civilian use had ended its slow increase and leveled off, and the resulting "inflationary gap" between spendable dollars and civilian supplies steadily mounted. On the cost side, the heavy requirements of the armed services for men and materials, the continued burden on transportation facilities, and the need for pushing agricultural production to high-cost "marginal" levels, forced production costs higher still. It was despite an increase of inflationary pressures, therefore, and not because of any reduction in those pressures, that the cost of living was arrested in its rapid climb and held for 12 months.

The Program to Halt the Rise

The program of the Office of Price Administration which made this record possible was announced April 30, 1943, and originally comprised four main points:

1. The reduction of retail fruit and vegetable prices, which had got out of hand, back to levels reflecting reasonable distributors' margins and farm returns.

2. The reduction of retail meat and butter prices by 10 percent, with a

squeeze on processors or producers prevented by payment of a subsidy at the processor level.

3. The rapid establishment of specific dollar-and-cents prices, community by community, so that housewife and retailer alike might know the exact ceiling prices.

4. The tightening up of enforcement to eliminate violations, which even in legitimate stores, including those reporting prices to the Bureau of Labor Statistics, were found to have resulted in food prices averaging 5 percent above ceiling levels.

The program was put into effect as rapidly as possible. In addition to the original program, key cost-of-living prices which otherwise would have had to rise still further were held stable by the use of subsidies to cover increased costs of production. These included milk and butter prices and those of bread and family flour. In both these cases the rise of grain and feed prices was the factor that made action necessary, a rise which could not be prevented by price control because of the statutory provision that farm prices cannot be controlled below parity. Price advances of canned fruits and vegetables, apples, dried beans, peanut butter, potatoes, prunes and raisins, vegetable oils, and truck crops were also prevented with the help of subsidy programs.

Subsidies are, of course, only a single element in the program developed to effectuate the Stabilization Act. But they are an essential element. How essential, and why, it is the purpose of the following sections to make clear.

2. Why Subsidies Must Be Used

Two Objectives: Production and Stability

Our wartime national economic policy has two objectives. One is the fullest possible production of essential materials—of the goods that are necessary for waging war and those the civilian economy must have. The other is the preservation of the stability and balance—and in the longer run the strength and vitality—of the economy. These two basic objectives are closely linked. For, on the one hand, the basis of economic strength is production, and, on the other, stability is essential for the full and efficient use of men, machines, and materials. Despite this fundamental harmony between the objectives of production and stability, however, there are particular situations in which the achievement of the one raises special problems in the achievement of the other. It is to deal with such situations and to eliminate any friction between the production and stabilization programs, thereby permitting their basic harmony to prevail, that subsidies are necessary.

The typical situation where production and stability come into *apparent* conflict is one where production costs have risen until they exceed the stabilized selling price of the product. Clearly, the producer must be assured a return that covers all costs if production is not to suffer. Yet, on the other hand, stability requires that the price to the consumer not be raised. In such a sit-

uation, therefore, the two basic economic requirements appear to come into conflict.

Price Need Not Be the Sole Source of Return

This apparent conflict is easily resolved and the solution to both parts of the problem becomes obvious, however, as soon as one recognizes that the price paid by the consumer need not, in an emergency, be the sole source of return to the producer. What the producer gets from the ultimate consumer in the form of a market price can be supplemented, in those cases where the return is inadequate, by payments from the Government. Alternatively, the price at the producer's level may be permitted to rise to the required height, but the Government may prevent this price from being reflected over the retail counter by payments to processors or others between the producer and the consumer. In either case the producer receives an increased return while the price to the final user is held unchanged.

War Strains Force Costs Up

It must be borne in mind that certain costs are bound to increase, regardless of our ability to stabilize raw material prices and wage rates. New and more expensive raw materials must commonly be substituted for those customarily used; less efficient facilities and less efficient labor must be utilized; foreign suppliers raise their prices; traffic congestion, breakdowns, and the hazards of ocean shipping increase transportation costs. Expanded food production demands use of less suitable land, poor equipment, and less efficient labor. A variety of such dislocations is inevitable in wartime. Every producer is familiar with one or more of them.

In many cases earnings are sufficient to permit these cost increases to be absorbed. In many other cases they may be offset by wartime economies of production. There will nevertheless be cases where the return must be increased if production is not to suffer. If in all such cases, however, prices were to be increased, obviously there could be no stabilization.

Price Increases Must Be Used Sparingly

Rising costs present problems for price stabilization wherever they are felt. For it has become apparent to all that one price increase frequently makes necessary a dozen others. These, in turn, require other adjustments and create further pressure throughout the economy.[1] Prices which enter the cost of living are particularly critical because of the impact which movements of the cost of living have upon wages and, through wage costs, upon industrial prices. Because of the central significance of the spiral of wages and the cost of living, the price control authorities must be particularly on guard against permitting

[1] For a detailed discussion of the ways in which prices react upon one another, see p. 7, below.

increases in cost-of-living prices. This has been found true not alone in the United States but, earlier, in Great Britain and Canada.

It is less frequently appreciated that effective price control requires not only that the impact of one price rise upon other prices be avoided but that prices, once determined, remain unchanged for a reasonable period of time. If a price regulation has to be frequently amended or replaced by new regulations, it becomes complex and irritating to businessmen. The regulation also becomes less effective and less enforceable, because the changes make it difficult for the seller, and frequently impossible for the consumer, to know what the ceiling is. Thus, both simplicity and effectiveness of price control require that price increases be avoided whenever possible.

The basic reason for using subsidies in the stabilization program, then, is to insulate prices, and particularly the cost of living, from the rising costs which war conditions make inescapable and which must be covered if essential production is to be secured. We turn now to an examination of what the Nation gets for this expenditure of public funds to cover these particular costs of war.

3. Savings Made Possible by the Use of Subsidies

There is widespread appreciation, both in Britain and in Canada, that the subsidy program, by helping to stabilize living costs and the wage bill, is saving the country far more than it is costing the treasury. The principles involved may be illustrated if we turn to the program now in effect in the United States and compare the cost of the subsidies with the costs that would result under the price and wage adjustments that would be necessary if subsidies were not used.

Even when we take the narrow view and ignore the immeasurable damage that inflation could do to war production, war morale, and post-war adjustment, considering only the narrow financial results of using subsidies to help prevent inflation, we find that subsidies are an enormously profitable investment as compared to the alternative price and wage increases. They save the Government and consumers far more than they cost. In fact, even if we ignore the savings to consumers, they save the Government alone a great deal more than they cost.

Direct Savings

Some of the subsidies now in effect were introduced to make possible the reduction of retail prices. These are the meat, butter, and peanut-butter subsidies. Most of the present subsidies, however, have been used to avoid the alternative of price increases. The subsidy to offset increased feed costs to dairymen is typical of these. The effect of all, once in operation, is of course the same, namely to permit the current price, which may or may not represent a reduction from an earlier price, to be maintained. In all cases, the direct price increases that are avoided by use of subsidies exceed their cost.

548954°—44——2

All food subsidies together are costing about $1,350 million a year in April 1944. The annual *direct* saving to civilian consumers and to Government purchasing agencies, combined, arising directly from these programs amount to at least $1,820 million. On civilian consumers' purchases taken separately, the cost of the program is about $990 million, the remainder being paid on Government purchases. The *direct* saving to consumers, in terms of higher prices they would have to pay *almost immediately* if the subsidies were withdrawn, is at least $1,420 million. Following is a tabulation of current direct savings:

Direct Savings From Food Subsidies

(Millions of Dollars per Annum)

	Gross Saving	*Subsidy Cost*	*Net Savings*
Government purchases	400	360	40
Civilian purchases	1,420	990	430
Total	1,820	1,350	470

These direct savings result from several causes. First there are the higher margins which prevail in business when prices go up, partly because some costs (e. g., spoilage costs) rise when the cost of goods handled rises, partly because in many lines of business percentage margins, rather than margins expressed in dollar and cents, are long established business practice. If a product rises 3 cents in price at the processing level, for example, it may be necessary to raise its ceiling by 4 cents at the retail store. Second, numerous food products—bread is a good example—must be priced in whole cents per unit, so that a rise of, say, one-half cent in cost to wholesalers or retailers would require a full cent rise in the price to the consumer. Finally, there are cases in which a subsidy paid on only a portion of the supply serves to avoid a price increase which would otherwise have to be granted across-the-board, or in which the amount of subsidy paid to some recipients can be lower than that by which the price would have to be raised to all if the subsidy technique were not employed. Examples of these types of saving are given below. (See pages 10–11.)

Indirect Savings

These direct savings, substantial though they are, are the least important sources of saving from subsidies. Far more important is the saving to the Government and to consumers that results from the avoidance of the wage increases and further price increases that would occur if subsidies were not employed. An increase in the price of any important product under wartime conditions puts in operation a train of consequences which move irresistibly to further increases in prices and general inflation.

Price Repercussions

(1) The most important single type of repercussion operates through the impact of rising costs of living upon wages and rising wages upon costs and prices, but there are others which deserve attention.

(2) Thus, any price increase for a commodity that enters into the index of prices paid by farmers raises parity prices and may force a rise in ceiling prices for agricultural products.

(3) A rise in the price of a farm product which constitutes an important cost of production of other farm commodities will have even more serious repercussions. For example, if feed prices were raised, prices of meats, poultry, and dairy products would have to be increased to insure adequate production.

(4) If the price of one feed grain goes up, moreover, the prices of other feeds may have to be raised in order to preserve balance in the use of different feedstuffs.

(5) Another important type of price relationship exists between commodities that have the same use, either actually or potentially. If grain feeds go up, for example, those who use them will turn to protein feeds. This may give rise to a wasteful use of the latter feeds. In the many cases where rationing is not possible, such wasteful use can be discouraged only by permitting a corresponding price increase. A most striking example of this occurred in Germany during the last war, when the price of grease for lubrication was permitted to rise while the price of butter was held down. As a result of the discrepancy between the prices of grease and butter, it became cheaper for farmers to use butter for lubricating their machinery. This wasteful use of butter would never have occurred if the returns to producers of grease had been raised by granting them a subsidy instead of a price increase.

(6) Finally, any price increase breeds demands for other price increases simply on the grounds: "His price was raised, why shouldn't you raise mine?" Every break in the stabilization line undermines the strength of those who are trying to prevent a major collapse.

The Current Balance of Prices and Wages

The avoidance of all these repercussions is the reason why indirect savings from subsidies are so large. While the calculation of indirect savings to take account of all these repercussions could be little more than guesswork, the indirect savings from avoiding wage increases can be roughly estimated in dollars and cents. It is highly important that the dimensions of these particular savings be grasped, for since the spring of 1943 we have been faced by a situation in which the alternative to subsidies is a breakdown of wage stabilization, and a series of wage and price increases that would cost the Government many times the amount of the subsidy.

At the time the Commodity Credit Corporation Bill (H. R. 3477) was under consideration, rough calculations were made which illustrate the general dimen-

sions of the ratio of these savings to costs. With respect to these calculations, which are set forth below, it should be kept in mind, however, that they reflect only a part of the indirect savings which result from the use of subsidies and that the case for using subsidies does not rest solely on the avoidance of wage increases.

The food subsidy programs which would have had to be withdrawn if the Commodity Credit Corporation bill as sent to the President on February 17, 1944, had become law, were at that time costing $1 billion per year.[2] The direct saving to purchasers of these products was estimated at about $1,300 million. This subsidy expenditure of $1 billion was at that time directly preventing a rise of 7 percent in the cost of food and 3 percent in the total cost of living, as measured by the Bureau of Labor Statistics. The estimates of the price increases which *indirectly* would be caused by banning these subsidies were made on the basis of the repercussions which could be expected to follow the initial rise of 3 percent in the cost of living that would result under the bill.

Calculation of Indirect Savings

It is conservative to assume that if a rise in the cost of living occurred, wages and salaries would increase by four-fifths of the percentage by which prices rose. Some groups would probably be able to get a wage adjustment greater than the increase in the cost of living, particularly in view of the rise in the cost of living that has already occurred since September 1942, the base date of the Stabilization Act. Others would be able to get much less. The figure of 0.8 percent wage adjustment for every 1 percent price change is a conservative average. An increase in the cost of living index amounting to 3 percent would, on this estimate, entail wage increases averaging about 2.4 percent. Since wages and salaries will amount to about $100 billion in 1944, the increase in the wage and salary bill that would occur if the $1 billion of subsidies were eliminated would be well over $2,300 million.

What further effect would this have upon prices?

The most conservative assumption that it is reasonable to make is that the value of output would go up on the average by the dollar amount of the increase of wages and salaries. In some cases, to be sure, profit margins are wide enough so that an increase of wages could be absorbed without an increase in prices. Where profits are already low, however—and this may be true for essential firms even where not true for an entire industry—a wage increase would put pressure on prices for the industry as a whole.

In still other cases, prices are determined upon the basis of cost plus a percentage. This is often true, for example, in distribution, for reasons already referred to. It is also true under many Government contracts where prices are made on just this basis. Taking all these factors together, it is clear that the smallest increase to be expected in the value of aggregate national output as

[2] The cost of all the food subsidy programs combined exceeded $1 billion at that time, but not all programs would have been eliminated by this bill.

a result of a wage increase would be an increase equal in dollars and cents to the added wage and salary cost.

This is not the end of the matter, however. The price increases that would result from the initial wage adjustment would again raise the cost of living, and this, in turn, would require further wage adjustments. These wages adjustments, in turn, would lift prices further still.

The speed with which wage rates would react to the higher prices, prices in turn to the higher wages, wages in turn to these still higher prices, and so on, cannot be predicted accurately. Some wages can be adjusted very promptly, others less promptly. Salaries in general are quite "sticky," so long as prices do not rise too rapidly, but they too would tend to go up if price and wage levels rose. It is reasonably conservative to assume that, on the average, two rounds of wage and price adjustments, definitely geared to the initial and indirect increases in living costs, would occur within a year.

It should be noted that if wage rates have lagged behind movements of living costs, the wage and hence the price increases set loose by an initial stimulus may be both larger and more rapid. It is quite possible also that in view of prospective price increases there would be a general demand for wage increases *more* than offsetting rising living costs, in which case new inflationary forces, not directly connected with the initial price rise, would accelerate and amplify the spiral. It is assumed in the following calculations, however, that only two rounds of repercussions take place, geared in each case to 80 percent of the prior rise in living costs.

Total Savings of $4.50 to $8.00 for Every Dollar Spent

At the end of two wage and price adjustments, the cost of goods and services would have risen by about $3,300 million. The Federal Government alone will be purchasing nearly 50 percent of the gross national product and would presumably have to pay almost half the cost of any price increase. The saving on Government expenditures through the avoidance of price increases that the Government would otherwise have to pay is therefore about $1,600 million. The saving to consumers from the avoidance of these price increases is somewhat greater—roughly $1,700 million. When the *direct* saving to consumers from the avoidance of the initial price increases on the subsidized commodities is added to this, the total saving to consumers amounts to approximately $3,000 million. Thus the total saving on expenditures for Government and consumers together amounts to about $4,600 million. Since the cost of these subsidies was only about $1,000 million a year, the ratio of saving to cost is roughly 4½ to 1.

If we make the somewhat less conservative, but perhaps more realistic, assumption that a rise in wages would bring about not an equal dollar increase but rather an equal *percentage* increase in prices, the savings are still greater. On the basis of this assumption, savings on Government expenditures alone, at the end of two rounds of wage and price increases, are estimated at about

$3,000 million. Savings to consumers from the avoidance of indirect price increases are over $4,000 million, and when the initial direct savings of $1,300 million to consumers are added, the total is over $8 billion on Government and consumer expenditures together. The cost of subsidies needed to obtain this result being $1 billion, the ratio of saving to cost on this assumption is therefore no less than 8 to 1.

Differential Subsidies

Often only a portion of the supply of a commodity need be subsidized, since a substantial part of the supply can be provided profitably at the ceiling price. Marked variations in costs among the producers of a product are frequently found. In addition, many producers can profitably produce a substantial output at ceiling prices, although for additional production their costs would exceed the ceiling price. In such cases, subsidy payments, while necessary to insure the required production, may be limited solely to high-cost producers or the high-cost portion of each producer's output. In certain other cases, while all producers may need some subsidy to sell at ceiling prices, the amount of payment can be adjusted to the differing needs of the producers. Such "marginal" or "differential" subsidies naturally maximize both direct and indirect savings per dollar of Government expenditure.

Savings of $19 for $1 Spent

The most striking example of subsidies to marginal producers is the premium payment plan for copper, lead, and zinc, which has been operating since February 1942. In 1943 the subsidy on copper saved the Government almost $19 for every dollar spent. If high-cost copper had been obtained in 1943 by permitting copper prices to rise from the ceiling level of 12 cents to the price necessary to cover high-cost but vital production, users of copper would have paid an additional $650 million in the form of higher prices. To avoid this the Government made premium payments aggregating about $35 million for the high-cost copper, which was sold to manufacturers of war goods for 12 cents. The premium payments constituted the subsidy. Since virtually all copper goes into war goods bought by the Government, the subsidy made it possible for the Government to avoid paying a premium on the overwhelming bulk of the output in the form of additional direct costs of the copper component of war materials.[8]

Differentiation Under Food Subsidies

Application of essentially the same principle is found in a number of the food subsidy programs.

[8] A portion of these additional costs would have been offset by increased yield of excess profits taxation consequent upon the higher profits of low-cost copper producers.

Incentive Payments.—In the incentive-payment programs on potatoes and truck crops, premium payments were made to growers on that part of their acreage between 90 and 110 percent of the farm crop "goal" established by the War Food Administration. This is an extremely economical alternative to raising prices for the entire output of these products high enough to evoke equivalent additions to production.

Transportation Subsidies.—The subsidy on apples involves payment of a part of transportation costs for the marginal supply of apples which must be shipped from the Pacific coast to most other sections of the country. This avoids having to raise apple prices throughout the greater part of the country to make it profitable to pay transport costs on the marginal supply. A somewhat similar transportation subsidy is used for sugar. As in the case of nonferrous metals, payments are made under these two programs to avoid the necessity of letting the price of the entire supply equal the high marginal cost of a portion of it. The only essential differences are that in these programs transportation represents the marginal cost, and a rebate of costs rather than a premium payment is employed to cover it.

Other Differentiation.—In other food subsidy programs, while payments cannot be confined solely to marginal producers, they are differentiated in amount to reflect the varying needs of different recipients. The payments to permit canners of the civilian pack of vegetables and fruits to sell at ceiling prices without hardship was geared to the needs of the individual canners. So, too, are payments to processors of soybean oils. Payments on several other foods reflect differences between the support prices which must be paid in different sections of the country to qualify for the subsidy.

Payments under the dairy feed program vary by regions to reflect the fact that feed costs have increased by different amounts in the different regions, and that in some areas prices have been increased as partial offsets to higher costs. Payments also differ under the regional fluid milk programs and the bread and flour and beef subsidies. In the beef program, nonprocessing slaughterers receive a higher subsidy payment than the large processing packers and all slaughterers have their payments reduced for any amount by which, on the average of each month, they pay less than "floor" levels for their cattle. The benefits of the several programs under which the Government sells feeds below cost for the purpose of preventing increased production costs and consequent higher prices of meats, dairy products and poultry are of course available to any eligibile feed user, but the great bulk of the subsidized feeds actually go into feed-deficit areas, where feeding and other production costs are abnormally high.

Thus the same marginal and differential principles used in most nonfood subsidies—namely, the payment of subsidies only where and in the amounts necessary to get adequate production at ceiling prices—are carried out in most of the food subsidy programs. It is impracticable to take advantage of these principles in every program, or to carry them in every case to the same lengths.

4. Methods of Granting Subsidies

Direct Payment

Several possible mechanisms are available for making these payments. One is a direct payment of the subsidy to producers or distributors, depending upon where the pressure on returns is being felt, or, in case prices for the industry are realigned generally, where the subsidy can be most efficiently administered. This commonly is at the processor level. For example, the peanut butter subsidy is paid to the manufacturers rather than to wholesalers or retailers primarily because of the smaller number of firms to which payments must be made.

Purchase and Sale

A second method is for the Government to purchase the entire output of the product to be subsidized and to sell it back to the industry or to consumers at a lower price than was paid. The loss resulting from sale at the lower price constitutes the subsidy. By this means the Government can pay a price to the producer high enough to insure adequate production, while at the same time the product can be made available to processors and distributors and thereby to consumers at a lower price than would be possible without the subsidy.

This method, like the first, is used extensively in Canada and Great Britain. In Canada, the Commodity Prices Stabilization Corporation, especially created for the purpose, conducts these purchases and sales. This method has also been used in the United States. For example, the Commodity Credit Corporation purchases peanuts and soybeans from producers and sells them to crushers at lower prices, thus permitting vegetable fats and oils to be processed and sold at stable prices while sustaining the Department of Agriculture's support prices, established so that production of peanuts and soybeans may be increased.

The third method of subsidy, which in fact is only a variation of the second, is for the Government to purchase, not the entire output, but that portion of the output of a commodity which is produced at a cost higher than is covered by the ceiling price and to sell it to the industry at the ceiling price. This method has been used, for example, in connection with imported metals needed for war production.

Operation at a Loss

A fourth method of subsidization is the provision of a service by the Government at a loss. This method has been used only in connection with the provision of services that have mounted in price directly because of war conditions. For example, during the period when submarine activity was causing severe losses to our shipping, the War Shipping Administration, in order to stabilize the cost of war risk insurance to shippers, insured commodities at stable rates and absorbed any amount by which claim payments exceeded premiums. Commercial insurance rates had skyrocketed, and without the Government's program for providing insurance at stable rates, the continued importation of goods at stable prices would have been impossible.

5. Analysis of Objections to Subsidies

The program expanding the use of subsidies into one of the key techniques for stabilizing the cost of living has given rise to a host of objections. The weakness of most of the objections to the use of subsidies is that they ignore the alternatives which must be faced if subsidies are not used. Let us consider each of these objections in turn, remembering as we do so that we are dealing here with subsidies as a means of avoiding and preventing price increases without injuring production. Under such circumstances, the alternative to the use of subsidies must be a rise in the cost of living and an upward swing in the spiral of prices and wages. (See pages 3–5, above.)

Objection 1: "Subsidies Lower Prices, Are Therefore Inflationary"!

This objection takes various forms. In its most confused form the argument is that subsidies to hold down or reduce prices leave people with more money to spend upon other commodities, and are therefore inflationary.

Now, of course, to say that lower prices are more inflationary than higher prices is to say that down is up! Probably what people have in mind when they make this argument is that if we were to let prices go up without letting incomes go up—a virtually impossible task—the price increase would prevent or discourage people from buying, and that if we hold prices down we shall have to restrict their purchasing by other means. But in wartime this necessity must be faced in any case. In time of war we cannot use rising prices to prevent purchases of necessities by consumers, for to do so would be to distribute essential supplies to the people who have the longest purses. It is precisely to avoid such an inequitable distribution of scarce necessities that we have price control and rationing in the first place.

In any event, this argument completely overlooks the fact that if prices were permitted to rise, then sooner or later, and probably sooner, wages and other incomes would have to be adjusted to the increased cost of living. Moreover, the rise in parity prices would require an increase of ceilings on farm products and this would result in an increase of farm money income. The increase of money incomes resulting from these wage and price adjustments would give consumers far greater purchasing power than would be absorbed by the initial higher prices. These adjustments, therefore, magnify the consequences of a price rise. On the other hand, even an across-the-board subsidy avoids this inflationary result, and a subsidy that is limited to high-cost production reduces still further the relatively small increase of income resulting under any subsidy program. This objection assumes that subsidies release more purchasing power for expenditures upon other commodities than a price increase with all its indirect effects would do. This assumption is simply not correct.

Objection 2: "Subsidies Increase War Expenditures, Thus Feed Inflation"

Another reason is advanced for supposing subsidies to be inflationary. It is recognized that the increase of war expenditures is the underlying cause of the inflationary danger. Does it not follow, it is argued, that a further increase, such as is involved in the payment of subsidies, aggravates that danger? Here again, however, the answer is clear when the alternative to subsidies is borne in mind.

A rise in prices would involve an increase in Government and private expenditures far greater than the increase which the subsidy expenditures involve. In fact the rise that a price increase would cause in Government expenditures alone is far greater than that involved in the payment of subsidies. This follows from the fact that the Government is now the major buyer of goods in the American economy. It has been noted above that in the fiscal year 1944 the Government will probably purchase almost 50 percent of the gross national product. Its expenditures will be nearly $100 billion and of this total about $75 billion will be spent on goods alone. A 1-percent increase in the prices Government must pay for goods would cost it in the neighborhood of $750 millions. The subsidies required to forestall such an increase fall far short of this sum. Thus, even when one looks only at the direct effect on the public treasury, the cost of subsidies is much less than the cost of rising prices. Contrasted with the alternative, subsidies not only constitute a definite economy, but also involve a smaller expansion of purchasing power, and are therefore anti-inflationary.

Objection 3: "Subsidies Shift Our Grocery Bill Onto the Future"

This failure to see that the alternative to subsidies is higher prices and higher wages has led some critics to contend that the program involves "shifting a part of our grocery bill" to future generations, and especially to our returning servicemen. The tacit assumption is clear that the post-war national debt will be larger if subsidies are continued than if they are withdrawn. Since this assumption is incorrect, the erroneous conclusion is understandable.

As explained above, the foodstuffs, textiles, and military equipment used by our armed forces will rise in price if subsidies are removed, and the Government will consequently have to borrow much more than the cost of the subsidies to pay the added bill. The returning servicemen and their children will be taxed to pay interest on this higher national debt. Ironically, they will make these payments to those very persons whose incomes and bondholdings have been increased by the price spiral which the use of subsidies would have prevented. Ironically too, the profits of the inflation will have been earned from the same forces causing a decline in the value of fixed incomes, pensions, and allotments, leaving many servicemen's dependents in want. These dependents will be paying higher grocery bills now, and the servicemen will be paying again when they return from the war. There could hardly be a greater

disservice to our men in uniform and to future generations than to make them pay interest on an inflated national debt incurred to fight a high-price war.

Objection 4: "Subsidies Only Conceal Price Rises"

Another objection sometimes made is that the use of subsidies does not prevent price increases; it merely conceals them. The basis of this argument is the claim that the subsidies involve taxes which are as great as the price increase that is avoided. For example, it is said that the use of a subsidy to avoid an increase in the price of butter from 50 to 55 cents a pound merely means that the public pays 50 cents for butter and 5 cents in taxation instead of paying 55 cents for butter, and that the public is no better off.

Here again the argument ignores the indirect effect of a price rise upon wages and upon prices generally. It cannot be stressed too strongly or too frequently that, whether the cost of subsidies is financed by taxation or by borrowing, the increase in the tax load or in the public debt is far less when subsidies are used than when prices are permitted to rise.

Furthermore, the argument that the public is no better off because what it saves in prices it pays in taxes ignores completely the very great difference in the impact of a price increase and the impact of additional taxes among income groups. Under our democratic system of progressive taxation, additional tax revenues are raised predominantly in accordance with ability to pay. A price increase, on the other hand, takes equal amounts from every purchaser regardless of his income, and thus takes a higher percentage of low than of high incomes.

The fact that inflation does bear so heavily and so unfairly on low income groups is a major reason for imposing price control in the first place. To say now that it does not matter to the consumer whether price increases are prevented or not is to deny completely this basis for price control.

Objection 5: "Consumers Can Afford Higher Prices"

A somewhat similar fallacy underlies the point, frequently made, that price increases are not objectionable because consumers have such high incomes that they can afford to pay higher prices. Figures are then cited to show that total income of consumers has risen by more than the cost of consumers goods and that consumers are consequently spending a smaller proportion of their total income than ever before. Here again the use of total figures conceals one of the major problems that price control is designed to meet.

The increase of total consumer income reflects extremely large increases in the incomes of some consumers and at the same time very small increases, no increases at all, or actual decreases in the incomes of others. The annual earnings of large groups of the population have not risen by nearly enough to compensate for the rise in the cost of living and in many cases have not risen at all. Between January 1941, the base date for wage stabilization, and January 1944, average weekly earnings (including overtime) in all nonagricul-

tural establishments rose 43.0 percent. When corrected for the rise in the cost of living during the same period, this percentage is drastically lowered to 16.1. Within nonagricultural establishments as a whole, real weekly earnings rose 37.6 percent in manufacturing and 46.5 percent in mining. In nonmanufacturing establishments, on the other hand, real weekly earnings increased only 3.3 percent. In this group are trade (up 2.2 percent), finance and service (increased 1.9 percent), and Government, in which real weekly earnings *declined* 5.2 percent.

In addition to these there are more than 20 million persons who are dependent upon pensions, military allotments, annuities, and similar incomes which cannot be increased by bargaining at all. Such persons are invariably squeezed in a period of rising prices. The contraction in the value of their incomes far exceeds the "squeezes" that are the subject of much complaint by some producers. When the cost of living rises, it rises for all. When consumer income rises, however, it does not rise for all. The increase of total consumer incomes is therefore no test of the ability of consumers to pay higher prices.

Moreover, the fact that total consumer income has increased more than the value of consumers goods is itself largely a reflection of inflationary forces, although it also reflects success in controlling prices. Expenditures on consumers' goods have been held down because the physical quantity of consumers' goods has been curtailed and price rises have been restrained. The increase in incomes on the other hand, reflects increasing production and employment in war industries, as well as increases in wage rates, profits, and farm prices.

The increase of consumer income in excess of the rise in the value of consumers' goods and services is a general characteristic of war periods. If incomes did not rise faster, there would be no upward pull upon prices. The disproportionate growth of consumer income is, in other words, a reflection of the very thing that causes the inflationary pressure. To raise prices on the theory that a high level of consumer income justifies an increase would inevitably result in further increases of profits, farm incomes, and wages, and therefore of consumer incomes. The increase of consumer incomes would, on this theory, justify still further price increases. This, in turn, would force further increases in consumer incomes, and so on, indefinitely. Thus, if this argument were to be translated into practice, it would result in continuously rising prices.

Objection 6: "Costly Subsidies—Tiny Savings"

Another related mistake is involved in the objection that the saving to the public from the avoidance of particular price increases would be only a few dollars per person and that the prevention of this increase in prices through a subsidy program is not worth the effort it involves. This argument has all the characteristics that appear in arguments against price control. Not only is it wrong as to the facts, but it is likely to lull the public into forgetting that inflation must be fought every step of the way.

It is wrong as to the facts because it takes into account only the initial price increase that the subsidy avoids, while completely ignoring the forces that cause one price increase to give rise to others and thus to generate the spiral of inflation.

Second, the argument that any given price increase is insignificant is the siren song that all price-controlling authorities have to resist. No single price increase taken by itself will upset the economy, say applicants for a higher price. It is true that any particular price increase may in itself be insignificant, but the enormous sum total of consumers' goods itself consists of a vast number of just such separately "small" components and it is precisely that multitude of individually minor pressures with which the price-controlling authorities must cope. Such small increases, each one directly affecting only a tiny fraction of the total volume of goods, are, when taken together, just the stuff of which inflation is made.

Furthermore, again the point comes to the fore, these "small" increases are not small to persons at the lowest levels of income, whose need for protection against the burden of inflation is greatest. The use of an average figure to indicate what a price increase would mean to consumers disregards completely the fact that sums which are relatively small to people in the middle and higher income brackets are substantial to those less fortunately situated.

Objection 7: "If Subsidies Are Used Now, Won't Prices Fall When They Are Withdrawn After the War?"

The answer to this question is a flat "no." The subsidies here in question are a part of the price control program. They will be withdrawn when the danger of inflation has disappeared, at a time when retail price ceilings can be removed. Thus there will be no squeeze when the subsidy is withdrawn.

Not only is there no reason whatever to suppose that the withdrawal of subsidies will cause a decline in prices to producers, but there is good reason to suppose that a subsidy program makes a decline far less likely to occur. If we permit inflation to develop, a sharp post-war fall in agricultural prices is virtually inevitable. Since the price stabilization program cannot work without the subsidy program, a sharp rise and a sharp fall of prices are far more likely to occur without such a program than with one.

Objection 8: "Subsidies Are Valueless Unless Wages Are Completely Frozen"

This objection takes the following form: "The main purpose of holding prices down is to aid wage stabilization. The Little Steel Formula has not been adhered to with absolute rigidity, and there is no absolute assurance that wages will not continue to rise even if prices do not. Subsidies, therefore, can be of no value."

While complete stabilization in all sectors of the economy is of course desirable, the value of subsidies is not predicated on perfection of achievement

on either the wage or the price front. Some prices must go up. So must some wages. The argument for subsidies inheres simply in a recognition of the intimate and dynamic relationships between prices and wages. To control either, it is essential to assure stable living costs. Any restraint on living costs helps check wage increases, prevents further price and wage increases, and contributes substantially to total stabilization.

Even a flexible wage line would not nullify the fundamental objective of subsidies. This crucial fact has been explicitly recognized in both Canada and Britain, where systems of wage adjustment have been provided to compensate labor for any increase in the cost of living index. It is significant that in both countries comprehensive subsidy programs have been instituted to run concurrently with the flexible wage adjustment programs—subsidies declaredly designed to minimize wage increases by holding costs of living. Canada and England have had flexible wage lines, but they have wisely perceived that a flexible line that is under control is preferable to the inevitable consequence of uncontrolled living costs—the absence of any wage line whatsoever.

Objection 9: "Subsidies Are No Substitute for Enforcement"

Beyond these objections, which fail to take into account the basic nature of inflation, are certain other points which are valid and which require consideration. The first is that there is no use in preventing price ceilings from being raised if they are only disregarded and that under such circumstances it would be better, in fact, to permit the ceilings to rise so that the illegal margin between selling prices and actual prices is decreased and money taken out of the hands of violators of the law. This is not an argument against subsidies; it is an argument in favor of enforcement. The Government does not propose and never will propose the use of subsidies as a substitute for enforcement. On the contrary, it proposes to push enforcement harder than ever, and it has taken effective steps to do so.

The Office of Price Administration has simplified its controls by replacing most of the diverse ceilings that existed under the General Maximum Price Regulation and other regulations by dollar-and-cents price ceilings, which are as uniform as customary trade practices and cost differentials permit. This program has gone far and it is being pushed further. It permits consumers to know what price ceilings are and makes it possible for them to recognize violations where they exist.

This program constitutes a major advance in the enforcement of price control. In addition, since the summer of 1943 the Office has spent a substantially larger portion of its appropriation on operations of field offices and local boards, where enforcement activities are conducted. Finally, the subsidy program itself contributes to the enforcement of price ceilings by enabling the Government to check up on conformity with its regulations simultaneously with the administration of the program.

Objection 10: "Subsidies Are Subject to Abuse"

It is also argued that a subsidy program is subject to abuse. That possibility does exist. It exists with any Government program and it must be guarded against. The Government recognizes that a subsidy policy must be hedged about with safeguards. A great deal of thought has been given to this problem, and standards have been developed for the application of this policy. The existence of the problem, however, should not inhibit us from taking necessary action. Standards to protect the public treasury and to make certain that no vested interests grow up are no more necessary in connection with the subsidy program than they are in connection with many other war programs which governments all over the world are now prosecuting. They have been developed in connection with procurement programs; they can be and have been developed in connection with the subsidy programs. The question is simply whether we will face the danger of one potential evil or whether, for fear of it, we will subject ourselves to a certain and greater evil.

We do not refuse to fight the war merely because the procurement of munitions opens the door to abuse. On the contrary, we face that problem and seek to surmount it in order to accomplish the greater purpose. The same rule is applicable in the use of subsidies.

Qualified Objections to Subsidies

Concern over possible abuse and waste in the use of subsidy funds perhaps accounts for the frequency with which approval of this technique for economic stabilization, while given, is qualified. Some of the reservations are very sound ones. Among these are limitations upon total subsidy expenditure and a requirement that subsidies be paid only to the extent required to promote production of essential goods at stable prices. Qualifications of this character are universally recognized as desirable. On the other hand, certain reservations commonly made are based upon misconceptions. These misconceptions threaten to give rise to inadvisable restrictions which might impair subsidy operations. The following four forms, which qualified approval sometimes takes, fall into this group:

Objection 11. "Producer Subsidies Are Good—Consumer Subsidies Are Bad"

The distinction often drawn between so-called "producer subsidies" and "consumer subsidies" arises from failure to see the two inseparable purposes of each of the programs. In every case the subsidy is being paid to reconcile full production, which in some cases requires higher returns to producers, with the requirements of economic stabilization. In every case, if subsidies were not paid, either the retail price would have to be raised or returns to producers reduced.

We could get the required production of each subsidized commodity by letting its price rise high enough. It would be unwise, but it could be done. On the other hand, we could hold the price stable and do without the last few percent of production. That, too, would be unwise. The virtue of subsidies is that they permit us to avoid both of these undesirable alternatives. They hold prices *and* promote production. They are in reality a subsidy neither to the producer nor to the consumer, but simply a means of bridging the gap between high producer cost and stable consumer prices.

This dual character of the subsidy programs can be illustrated by two examples. The subsidies paid for high-cost production of copper, lead, and zinc are commonly regarded as subsidies to aid production. But they are as intimately related to price stabilization as they are to production, for if the subsidies were not paid the price ceilings could be lifted in order to evoke the required production The dairy feed payment program, on the other hand, has been criticized by some as a "consumer" subsidy. It is quite true that it prevents the retail price of milk and other dairy products from rising. But it is equally clear that it aids production, since it is a payment to enable dairy farmers to cover the increased costs of operations. The purpose is to insure maximum production, but without puncturing price ceilings. Every existing subsidy program, fully analyzed, reveals this same dual purpose: stimulus to production *coupled with* stable prices.

Objection 12. The Alternative of a "Food Stamp Plan"

One objection to subsidies, interestingly enough, arises from a desire to subsidize only consumers whose incomes are below a stated level. Adherents of this view, while agreeing that Government funds should be spent to cushion the impact of high wartime food costs upon consumers, feel that the funds should not be used to hold down prices for everyone but rather should be confined to supplementing the purchasing power of low-income consumers. Their proposal is to withdraw the present subsidies, thereby letting the prices of the subsidized foods rise, but to issue stamps which could be used by certified low-income consumers to purchase any foodstuff. The stamps would be redeemed by the Government. A similar system, confined to relief clients, was in use before the war when there were surpluses of foods.

Although much can be said in its support, the food stamp plan is plainly no substitute for the price-restraining subsidy program. Its fatal defect is its failure to protect the Nation as a whole against inflation. It would, if the administrative problems entailed could be successfully solved, relieve some consumers from the immediate impact of inflation. Yet inflation has many evil consequences for the social and economic life of the community besides deprivation of those groups that cannot keep pace in the inflationary spiral. No program for mere alleviation of suffering can be a substitute for a firm wartime stabilization policy.

Furthermore, since the food stamp plan would not prevent prices from

rising, it would do very little to reduce the pressure for higher wages and other incomes which is the natural result of rising prices and one of the chief causes of the inflationary spiral. The inflationary spiral, as shown above, breeds ever greater purchasing power. Government expenditures which damp down or eliminate the spiral are therefore anti-inflationary. Government expenditures under the food stamp plan, which are estimated to be considerably larger than those currently made on subsidies, would truly be inflationary in tendency because they would be associated with rising prices and rising incomes.

Objection 13. "Subsidies on Marginal Production Are Good—Subsidies 'Across the Board' Are Bad"

There are some persons who support the use of subsidies where they are paid only for marginal production but oppose their use where the entire output is affected. They are impressed by the savings which result by paying a higher return on only a part of the output as against paying a higher price for the entire output. Where this saving is not made, however, they hold that subsidies should not be used.

There can be no dissent from the view that differential subsidies (see p. 10, above) are especially effective in terms of the immediate results accomplished for the cost involved. It would be ideal if in every instance the subsidy payment could be geared exactly to the portion of production requiring the increase. But this is not always possible and where it is not this extra advantage and extra saving must be foregone.

The saving that results from the differential feature of any subsidy, however, is minor in comparison with the saving effected by maintaining stability of prices. The real savings are always those that come because stabilization has been maintained.

If one is particularly impressed with the marginal principle, it may be helpful to bear in mind that even across-the-board subsidies are marginal in a very fundamental sense. They are designed to cover the extra costs that result from wartime pressures, strains, and dislocations. These costs conceivably may affect every producer within an industry, yet they are marginal for national production as a whole. They are the wartime costs resulting from wartime strains in getting the extra, marginal production needed to win the war. After the war, when those needs and those strains disappear, so too will the extra costs.

If we use subsidies to cover these marginal costs, enabling the price which covers ordinary costs to remain stable, that price will still be in effect after the war, when the disappearance of the extra costs will make possible the elimination of the subsidy. On the other hand, letting the price rise to cover these wartime costs must mean generally rising prices, general instability, and almost certain collapse after the war. In such a collapse, as everyone recognizes, prices do not stop at the level of costs—they plunge right on down without regard to costs.

Objection 14. "Hold-Back" Subsidies Approved—"Roll-Back" Subsidies Disapproved

A false distinction is also sometimes drawn between those subsidies which prevent retail prices from rising and those which enable retail prices to be reduced from levels previously attained. The latter, or "roll-back" type, has been used for three commodities—meat, butter, and peanut butter—to meet particular problems faced at the time the hold-the-line program was getting under way. It appears to have aroused opposition even from many who support other types of programs.

It should be clear, however, that a subsidy to reduce a price which has risen is no different, except in timing, than a subsidy applied earlier to prevent that price from rising. If the "roll-back" subsidy had been instituted early enough, there would have been no price rise and it would have been a "hold-back" subsidy.

A part of the opposition is obviously based on the erroneous impression that the roll-back applies to the price of the farm product. This is incorrect. The roll-back applies at the processor level only, and the subsidy payment is scheduled to offset the reduction of ceiling prices at that level. Thus not only is no formal reduction of the farm price involved, but the processor remains in an unchanged position to pay previously prevailing prices to the farmer. The use of a direct subsidy payment to the farmer instead of a higher "supply and demand" price at the grower's level, while present in a number of "hold-back" subsidies, is not involved in any of the three "roll-back" programs. In all of the latter the producer receives his full price through the market.

The techniques employed in "roll-back" subsidies do not differ in any significant respect from those used in "hold-back" programs. The three "roll-back" subsidies take the form of payments made to processors to enable them to continue paying support or prevailing prices for raw farm products despite reductions in retail prices of the processed foods. "Hold-back" subsidies are also typically payments to processors, made to enable processors to pay support or prevailing prices for farm products without raising consumer prices.

It is worth noting that no distinction between "roll-back" and "hold-back" subsidies has arisen in either Canada or Great Britain. "Roll-back" subsidies have been used extensively in both countries to lower or hold general living costs in the face of increased prices for some cost-of-living commodities. Subsidized items have been chosen primarily for administrative simplicity and importance in the cost of living, and no sanctity has been attached to the existing level of any individual price.

6. The Test of Performance

There is a very strong case to be made for subsidies on the basis of the behavior of the cost of living since April 1943. The "hold the line" program as a whole has plainly resulted in complete stability of the cost of living as measured by the Bureau of Labor Statistics. If the reasoning set forth in the

preceding pages is correct, this result could not have been accomplished without the use of subsidies as an essential part of the stabilization program.

In achieving this result we have matched the record of the British and the Canadians and in some respects have improved upon it. It is important, in viewing our own problems of wartime production and stabilization, to realize that, like us, no other major belligerent—with the single exception of China, whose experience stands as a warning—has accepted either the alternative of rising prices or that of strangled production. All have insured high production within the framework of stable prices. They have done this by using subsidies to insulate the cost of living from rising production costs. It is the wise and effective use of subsidies that has enabled both the British and Canadians to reconcile the imperative of economic stability with the imperative of wartime production.

The great production achievements of the British are widely known. It is not so well known that for nearly 3 years the cost of living in Britain has been held to virtually absolute stability and the retail cost of foods has even been reduced. Evidence of effectiveness of British stabilization is found in the fact that, whereas between the outbreak of war and May 1941, the cost of living rose 29 percent, between the latter month and February 1944, it remained completely stable. During this period, moreover, the retail price of foods in Britain, which had risen 25 percent above pre-war levels, was reduced 1.8 percent.

Similarly in Canada: Cost of living stabilization was made national policy in December 1941, and subsidies were used from the outset in effectuating that policy. The cost of living had risen 15 percent at that time. In the 2¼ years that followed, down to March 1944, the net increase in the cost of living was only 2.8 percent.

The relation between the effectiveness of British and Canadian stabilization and the use of subsidies is indicated by the extent to which prices entering the cost of living index are subject to subsidy. In Britain 92 percent of the food component of the cost of living index is affected by subsidy. This means that 55 percent of the total cost of living index is affected by food subsidies alone. In Canada, 15 percent of the total cost of living index and about 50 percent of its food component are subject to subsidy. Of the 45 food items in the index, 22 are covered by subsidy programs.

The experience of Great Britain and Canada—as well as our own—is striking demonstration of the effectiveness of subsidies as part of an integrated system of price control. Subsidies work. They enable a country to hew to the line on a firm stabilization policy and at the same time to get production to the limit of its capacity.

○

OLUMBIA UNIVERSITY LIBRARIES
low, or at

MSH 26474

END OF
TITLE